



## STATE BOARD OF LAND COMMISSIONERS

Dirk Kempthorne, Governor and President of the Board

Pete T. Cenarrusa, Secretary of State

Alan G. Lance, Attorney General

J. D. Williams, State Controller

Marilyn Howard, Superintendent of Public Instruction

Stanley F. Hamilton, Secretary to the Board

### FINAL MINUTES Special Land Board Meeting December 21, 2000

A special meeting of the Idaho State Board of Land Commissioners was held on Thursday, December 21, 2000 in Boise, Idaho. The meeting began at 3:35 p.m. with the Honorable Dirk Kempthorne presiding. The following members were present at the meeting:

Honorable Secretary of State Pete T. Cenarrusa  
Honorable Attorney General Alan G. Lance  
Honorable Superintendent of Public Instruction Marilyn Howard

Secretary to the Board Stanley F. Hamilton

State Controller Williams participated in the meeting via conference phone from 3:35 p.m. until 3:55 p.m.

#### • REGULAR AGENDA

##### 1. Endowment Fund Investment Board Update – *Presented by Charles G. Saums, Investment Manager*

Based on the current volatility of the equity market, Governor Kempthorne felt it was prudent to hold a special Land Board meeting to discuss the status of the Endowment Fund.

Participants: Charles G. Saums, Investment Manager, Endowment Fund  
Dr. Nick Hallett, Chairman, Endowment Fund Investment Board  
Mike Bledsoe, Investment Manager  
John McCune, Investment Manager

*(Mike Bledsoe and John McCune are Managing Partners  
of Capitol Investment Advisors, a Division of D. A.  
Davidson)*

**Dr. Hallett.** Is investment reform in the best interest of Idaho children? As the Endowment Board received recommendations for endowment investment reform, three caveats emerged. First was the need to take a long-term outlook. Second was the need to realize that no one can time the market. Third was the need for the earnings reserve. Dr. Hallett recommended that the Land Board stay the course. The plan has been carefully reviewed and has been developed with a great deal of prudence. The Endowment Fund Investment Board meets on a quarterly basis to monitor the Fund's performance.

**Mr. Saums.** In an effort to keep the Land Board informed of current market conditions, Land Board members were called to let them know that the market had declined to a degree that

could put February distributions to public schools in jeopardy. Mr. Saums suggested that a plan should be put into place to ensure that the distribution is made as scheduled.

Mr. Saums stated that performance of the Fund is reviewed quarterly; however, the status of the Fund is reviewed daily. The Fund is roughly 70% equity and 30% fixed income. Staying the course at this point is really maintaining the Fund at status quo.

Governor Kempthorne commented that the president-elect has suggested that the country may be headed toward a recession. He asked Mr. Saums what a recession would do to the market. Mr. Saums responded that a recession could do two things. If the Federal Reserve lowers rates, the market could be stimulated. Lower rates would allow stocks to carry a higher multiple. That in and of itself would give the market a slight boost. Also the possibility of a tax cut could stimulate the market. The market would see that as a good sign and it should react favorably.

Governor Kempthorne asked if the 70% of stocks are in high-risk stocks. Mr. Saums stated definitely not. The plan is a mix of nine managers who do specific styles of investing and the combination provides the Fund with less risk than if one individual manager had been hired.

Attorney General Lance asked who oversees the nine managers to make sure that their styles do not overlap too extensively in certain areas. Mr. Saums responded that a consultant reviews the managers to make sure holdings are not excessive. Attorney General Lance asked if a breakdown of the holdings was available. Mr. Saums stated that information could be made available. Attorney General Lance asked if someone was watching that breakdown. Mr. Saums stated that an asset list is available and it does a comparison. It lists every equity holding by all of the managers and also lists what percentage that holding is as related to the total portfolio. That information is generally received weekly.

Controller Williams asked if Mr. Saums had a cash flow projection from the viewpoint of what the obligation is to the various beneficiaries. He asked how much income is anticipated from the Lands portion of the portfolio and what the projected shortfalls would be in an adverse market. Controller Williams also suggested that a sub-committee be formed to look at this issue.

**Mike Bledsoe.** In response to Governor Kempthorne's question about what a recession would do to the market, Mr. Bledsoe stated that the market has already discounted a recession. Alan Greenspan spoke on December 5<sup>th</sup> and gave a good overview of where he thought the economy was headed and what the Federal Reserve's plans are in response to that. This is what happens if we do have a recession. It has already happened. The stock market is a discounting mechanism and does not reflect current economic conditions. It reflects conditions that are anticipated to exist six or twelve months down the road. In that sense, the market is anticipating a recession. If we have a recession, the market is probably where it should be. If we do not have a recession, this is a very oversold market and we do anticipate a strong rebound.

Given Alan Greenspan's comments, and realizing that the new Administration probably has tax cuts and economic stimulus packages at the top of its list, we are fairly confident that the market will go forward. We have already experienced most of the down side that will exist, even in a dire circumstance. Markets hate uncertainty and the next six months or so are very uncertain times. It is very murky. So the market simply takes the worst case scenario and discounts it. In our opinion, that is what has been going on. We believe there is a very good chance that the

Federal Reserve will ease rates before their next meeting on January 31<sup>st</sup>. At the very least they will embark on an interest rate easing policy. That policy should extend through the spring and into the summer, if necessary.

At this time, the board is contemplating what to do if there is an additional downturn from this point forward. The possibility of an additional downturn in the market should be given a low priority of occurrence. There is a much greater probability that the market will stabilize and will begin to move higher starting next year, if not sooner.

**John McCune.** The market moves in extremes. We all know about the dot.com craze and how far the market moved. The first part of the correction from the last six months was due to the fact that the market had moved too extremely on the positive side. The last part of it was a discounting mechanism. The market is discounting what might happen in the future based on the fact that maybe the earnings might be slowing down. This year we have experienced both extremes two or three times. It has been a very volatile market.

Governor Kempthorne asked if what has happened in the market suggests in any way that a reevaluation of the distribution needs to be made. Mr. Saums responded that it would not be appropriate to revisit the distribution at this point. There has not been enough time for a full evaluation. Dr. Hallett commented that the 70-30 mix was recommended based on the revenue from timber and on the cash reserve. As the cash reserve is created, this is the most vulnerable time.

Mr. Saums has spoken with Ray Houston and Controller J. D. Williams about possible remedies. One of the remedies suggested was that Mr. Saums could go before JFAC to request a supplemental loan. If the loan were needed, the moneys would be used and would then be paid back. If the moneys were not used, they would stay in place untouched. The advantage to this suggestion is that if the Fund was unable to make its February payment, the schools would have to go into the general fund to get supplemental moneys and those moneys would not be paid back. Mr. Saums stated he does agree with Mr. Bledsoe and Mr. McCune that the market will turn around next year. However, Mr. Saums said he would not bet the school's money on it.

Attorney General Lance asked if someone in the mix could say that an obligation was coming up in February, we made 25% on these investments and maybe we should salvage that profit by saving it. It could be rolled into a 6% instrument to assure the February payment rather than hoping that the market on the day before we sell is at a high. Mr. Saums responded that unfortunately the accounting does not work in that way. The Earnings Reserve is made up of the market to market of the entire fund. If the market value of the entire fund is a positive then we have a good running reserve. If you sell something and include it into cash, you in effect have changed the makeup of the fund. You moved it from one asset to another but it still has the same market value.

Mr. Saums stated he wanted to stress that the Fund is not broke. The point is that the money is not in the Earnings Reserve because of the decline in the market value. Cash can be raised and we have operating cash on hand. We have enough cash to pay this dividend because we set it up to do it in that manner. The problem is that all of the bills and distributions have to be paid from the Earnings Reserve. So even if you took that money and set it aside for the specific purpose of paying this bill, if the rest of the stock market dropped and you wiped out the Earnings Reserve, you could not touch the money anyway. The method of accounting that we

have to do to establish the Earnings Reserve has created the problem. The Fund is in tact. It is the paper Earnings Reserve that is going up and down. But based on the way we are structured, that is where bills are paid.

To summarize, Governor Kempthorne commented that in light of the current volatility of the market, Mr. Saums is suggesting that the board not make any changes in the current structure or in the philosophy by which the board has gone forward with this policy. Mr. Saums is informing the board that there has been an upswing and a down swing in the market. But aside from that, the current strategy is sound, no changes are being recommended at this point and the corpus is intact. Mr. Saums concurred.

Attorney General Lance stated he believes everyone has the same view, which is that the market could continue to go up. Money can be made when the market goes down; money can be made when the market goes up. At the next Land Board meeting, Attorney General Lance said he would like to know the mechanisms in place to make money when the market is going down. He asked if the managers had the flexibility to sell short. Mr. Bledsoe responded that his firm's investment policy expressly forbids selling short. He was unsure if short selling was allowed in any of these accounts or in the Fund.

Governor Kempthorne asked what the ratio is for other endowment programs. He asked if the 70-30 split is considered a standard ratio. John McCune responded that 70-30 is considered a fairly typical percentage. When the strategy was structured it was not structured in a way that people overseeing it were expecting the market to simply go up. If that were the case, it would have been invested much more aggressively.

Mr. McCune stated that the strategy was structured by looking at historical returns over a long period of time and under very extreme situations. The market's behavior has been very unusual and it occurred at a time when the reserve fund was vulnerable. Mr. McCune has been in the market for the last 15 years and has always counseled his clients against changing a strategic part of their plan based upon tactical occurrences that have happened short term in the market. If the client makes changes, they are playing a market-timing game, which nobody has really been able to prove they can do well in the long run. It is better to look at things in a strategic nature rather than in a tactical nature. Governor Kempthorne asked Mr. McCune if he was affirming that the strategy is still correct. Mr. McCune said absolutely.

Governor Kempthorne stated this item would be placed on the next Land Board meeting agenda so that the board can be updated on this matter. He asked Mr. Saums to determine a way in the interim that the board can be kept apprised of the situation. Mr. Saums stated he would develop a report to respond to questions that have been asked.

Ben Ysursa, Secretary of State's Office, suggested that, in the absence of a January Land Board meeting, the Governor might want to have a sub-committee meet. The Deferred Compensation Sub-Committee referred to by Controller Williams has participation from Mr. Ysursa, David High from the Attorney General's Office, Keith Johnson from the State Controller's Office and Darrell Manning and/or Dave Tolman from the Division of Financial Management. Governor Kempthorne asked Superintendent Howard if she would like to have someone from her office participate in the sub-committee. Dr. Howard stated she would have someone attend. Governor Kempthorne commented that the board would use this sub-committee as a bridge to keep abreast of the situation. Governor Kempthorne asked Mr. Saums to communicate with the group after the first of the year.

Mr. Saums asked Governor Kempthorne if asking for a supplemental loan was the proper course to take. Governor Kempthorne stated that the board would take the suggestion under advisement. After Mr. Saums meets with the sub-committee, the board will evaluate the current status. That current status will factor into the board's thoughts on whether or not the board concurs with Mr. Saums' approach.

With that, the Endowment Fund Investment Board update to the Land Board ended.

Next, Governor Kempthorne stated he had indicated there was a possibility of an Executive Session. At this point, he did not believe there was a need for the Executive Session and he felt that the board was ready to move forward with an announcement.

Prior to stating his announcement, Governor Kempthorne once again thanked Director Stan Hamilton for 17 devoted years provided to the Department of Lands and to the people of Idaho. Governor Kempthorne commended Director Hamilton for a record to be proud of.

Governor Kempthorne went on to say that because of Director Hamilton's announced departure at the first of the year, it was necessary for the board to name an individual to continue in that leadership role. Governor Kempthorne stated that Winston Wiggins was asked by the Land Board to become the Acting Director of the Department of Lands. Mr. Wiggins accepted.

Governor Kempthorne stated that in the capacity of Acting Director, Mr. Wiggins has the full authority to perform the duties of the Director and has the support of the Land Board. During the next six to nine months, the board will evaluate the department. As the department goes forward, it will be facing new issues and new responsibilities. The department's current model will be evaluated to see if it is the right model to take the department into the new century.

Governor Kempthorne also announced the establishment of a Citizens' Evaluation Committee that will evaluate the department on behalf of the Land Board. The Committee will evaluate how the department is currently structured, how it operates and how we deal with resources. It will also look at the relationship between the resources and the endowment and the human resource issues of the people who work in the department.

Governor Kempthorne listed the Committee members:

- Mr. Don Curtis has agreed to be the chairman of the Committee. Mr. Curtis just retired from Hewlett-Packard and was one of the outstanding managers for that company. Mr. Curtis will provide the corporate view, the big view and the strategic view.
- Senator Marguerite McLaughlin, with her background in both government and natural resources, has agreed to serve on the Committee.
- Former Superintendent Jerry Evans, with his perspective on the endowments, has agreed to participate. Governor Kempthorne stated he appreciated Dr. Howard's concurrence and enthusiasm for Mr. Evans' appointment.
- Mr. Robert Maynard, Chief Investment Officer for PERSI, has agreed to serve. Mr. Maynard has a strong investment background.
- Mr. Mike Everett, Deputy Director for the Idaho Department of Agriculture, has agreed to serve. Mr. Everett brings his knowledge of state government to the Committee.

- Mr. John Cowden, retired Human Resource Officer from Boise Cascade, has agreed to serve. When resources are discussed, our people have to be at the top of the list.
- Mr. Gary Christensen, suggested by State Controller Williams, has agreed to serve. Mr. Christensen has a commercial development background.

Governor Kempthorne stated that this is not an exhaustive list. The Committee has the latitude to augment the list as it deems necessary. The Committee will go into effect after the first of the year through coordination between Director Hamilton and Mr. Wiggins.

On behalf of the board, Governor Kempthorne thanked Mr. Wiggins for his many years of service and for his willingness to take on the new responsibility. Governor Kempthorne stated that the department will face challenges ahead but Director Hamilton has given the department a good foundation from which to work.

Mr. Wiggins stated he would echo the Governor's comments. He feels there is a tremendous foundation at the Department of Lands built by Director Hamilton and by those who have gone before him and who have worked with him through the years. He stated he looks forward to helping the board, and the Citizens' Evaluation Committee, further build and improve that foundation.

Secretary of State Cenarrusa commented that he has appreciated having Director Hamilton as the department's director for the past 17 years. He was on the board when Director Hamilton was originally hired. Director Hamilton was believed to be the best of all of the candidates and he still is. Secretary of State Cenarrusa thanked Director Hamilton for a job well done and wished him the best. Secretary of State Cenarrusa advised Director Hamilton that if he should ever need a recommendation, he could use Secretary Cenarrusa as a reference.

- EXECUTIVE SESSION

2. To Consider Personnel Matters, Idaho Code § 67-2345 (1)(a)

As referenced above, the Executive Session was cancelled.

There being no further business to come before the board, the meeting adjourned at 4:25 p.m.

IDAHO STATE BOARD OF LAND COMMISSIONERS

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President, State Board of Land Commissioners and  
Governor of the State of Idaho

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Pete T. Cenarrusa  
Secretary of State

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Stanley F. Hamilton  
Director